

**Significant Progress Has Been  
Made to Increase the Percentage of  
Electronic Vendor Payments**

**February 2003**

**Reference Number: 2003-10-048**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

February 3, 2003

MEMORANDUM FOR THE CHIEF FINANCIAL OFFICER

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Significant Progress Has Been Made to  
Increase the Percentage of Electronic Vendor Payments  
(Audit # 200210027)

This report presents the results of our review of the Internal Revenue Service's (IRS) use of electronic vendor payments. The overall objective of this review was to determine whether the IRS has developed and implemented a process to maximize the use of electronic payments, including the granting of waivers, as intended by the Debt Collection Improvement Act of 1996.<sup>1</sup>

In summary, the IRS has made significant progress to increase the percentage of electronic vendor payments. The IRS could further maximize its efforts by fully considering the capability of vendors to receive electronic payments before establishing and maintaining automatic vendor waivers based solely on expense type (e.g., administrative summonses and tax lien fees), especially with vendors who receive multiple payments. We recommended that the Chief Financial Officer periodically review automatic waivers to identify vendors that are receiving recurring check payments.

Management's Response: IRS management agreed with the recommendation presented in the report. The Beckley Finance Center will conduct quarterly operational reviews beginning with data from the second quarter of Fiscal Year 2003 to ensure that vendors who receive multiple payments are contacted to ascertain their capability of receiving electronic payments. Management's complete response to the draft report is included as Appendix IV.

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<sup>1</sup> Debt Collection Improvement Act of 1996, 31 U.S.C. § 3332.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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the Percentage of Electronic Vendor Payments**

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## Significant Progress Has Been Made to Increase the Percentage of Electronic Vendor Payments

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### Background

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The final rule<sup>1</sup> for implementing the Debt Collection Improvement Act of 1996<sup>2</sup> states that all Federal payments made by an agency, except as waived by the Secretary of the Treasury, are to be made electronically starting on January 2, 1999. This rule does not apply to payments made under the Internal Revenue Code.<sup>3</sup>

Various waivers are provided within the rule for agencies that make Federal payments. These waivers include a cost benefit analysis showing that making non-recurring payments by Electronic Funds Transfer (EFT) is not justified, and instances in which there is only one source for goods or services and the Federal Government would be seriously injured unless payment is made by a method other than by an EFT.

Waivers for individuals are available in the final rule if the individual determines, at his or her sole discretion, that payment by an EFT would: 1) impose a hardship due to a physical or mental disability or a geographic, language, or literacy barrier, or 2) impose a financial hardship. A waiver form is required for these waivers.

Electronic payments offer advantages over issuing paper checks. The Financial Management Service (FMS) of the Department of the Treasury reports that electronic payments cost \$0.28 less than issuing a paper check. Also, electronic payments are less vulnerable to illegal acts than checks. The FMS reported that in Fiscal Year (FY) 2000, the Federal Government experienced \$60 million in forged checks, \$2 million in counterfeit checks, and \$3 million in altered checks. Further, the use of EFTs greatly improves Federal Government cash management, audit capabilities, and customer service.

The Internal Revenue Service (IRS) requested the Department of the Treasury to receive electronic payment waivers for vendors for tax lien fees, administrative summonses, and training. The IRS believed these to be one-time payments. The Department of the Treasury, in

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<sup>1</sup> Management of Federal Agency Disbursements, 31 CFR Part 208.

<sup>2</sup> Debt Collection Improvement Act of 1996, 31 U.S.C. § 3332.

<sup>3</sup> Internal Revenue Code, 26 U.S.C.

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consultation with the FMS, informed the IRS that it could grant automatic waivers for these one-time vendor payments. Further, it was not necessary to obtain a waiver form from these vendors. Once an automatic waiver is granted and recorded in the IRS' financial system, the vendor would continue to receive paper checks for all subsequent payments.

Our review was performed at the IRS National Headquarters in the office of the Chief Financial Officer (CFO) from July through October 2002, and included IRS-approved vendor payments from January 1 through July 31, 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### Electronic Vendor Payments Increased From 64 Percent to 96 Percent

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Significant efforts have increased the percentage of electronic vendor payments at the IRS. During the first quarter of FY 2002, the IRS had the lowest reported percentage (64.3 percent) of all Treasury bureaus for electronic vendor payments. By the fourth quarter of FY 2002, the IRS' percentage of electronic vendor payments, as reported by the Department of the Treasury, increased to 96.5 percent. The percentage used by the Department of the Treasury to measure compliance with the Debt Collection Improvement Act of 1996 is calculated net of check payments to vendors who have waivers.

Our analysis of approved payments for the month of July 2002 identified 10,587 electronic payments, 1,973 check payments with a waiver indicator on file, and only 27 check payments without a waiver indicator on file. Five of the 27 checks were not related to vendor payments; therefore, they were not included in our analysis. The remaining 22 checks were issued to 13 individual vendors. Eleven of the 13 vendors qualified under the IRS' practice of granting automatic waivers; however, the waiver indicator was not established in the IRS' financial system. For the other two vendors, the IRS informed us that it was in the process of obtaining confirmation of electronic payment information supplied by the respective vendors.

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During the months of February and April 2002, the IRS took various actions to improve its percentage of electronic vendor payments. For example:

- The CFO's office mailed letters to vendors receiving check payments and asked them to sign up for electronic payments. If this was not possible, the vendor was instructed to fill out the required waiver form.
- The Beckley Finance Center (BFC) started to review daily vendor payments. If a vendor was receiving a check payment and did not have a waiver indicator on file, the BFC would first determine if the payment qualified for an automatic waiver. If the payment did not qualify for an automatic waiver, the BFC would contact the vendor and attempt to get it to accept an electronic payment or submit the required waiver form.
- The CFO's office issued Standard Operating Procedure Number 021, *Returning Invoices to Commercial Vendors*. This procedure requires that invoices be returned to vendors if they did not submit electronic payment information or a valid waiver for not receiving payment electronically.
- The Office of Procurement issued Policies and Procedures Memorandum Number 32.11, *Implementing Central Contractor Registration (CCR) to Obtain Contractor Information with Electronic Funds Transfer (EFT) Information*. This directive established a policy that requires electronic payments for all new contracts entered into by the IRS.

Collectively, these actions had a significant impact on increasing the percentage of electronic vendor payments.

Our analysis of approved payments for July 2002 identified 1,973 check payments relating to 1,163 vendors with automatic waiver indicators present on the IRS' financial system. A more detailed analysis identified that 14 of these vendors received a total of 352 check payments, ranging from 10 to 69 payments per vendor, in July 2002. These

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**Electronic Payment Waivers Are Being Automatically Granted to Vendors Who Might Have the Capability to Accept Electronic Payments**

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same 14 vendors received a total of 1,196 check payments, ranging from 13 to 347 payments per vendor, from January to June 2002. See the table below for details.

### Vendors Receiving Paper Checks

Vendor	<u>Number of Checks Issued in:</u>		
	July 2002	January to June 2002	The 7-Month Period
1	69	347	416
2	38	13	51
3	38	90	128
4	37	147	184
5	29	102	131
6	21	66	87
7	20	79	99
8	20	74	94
9	17	34	51
10	16	75	91
11	16	50	66
12	11	68	79
13	10	32	42
14	10	19	29
Total	352	1196	1548

*Source: Data received on August 12, 2002, from the IRS' BFC.*



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The types of vendors and corresponding expenses exhibited above included:

- Seven banks for administrative summonses.
- Six clerks of superior courts for tax lien fees.
- One educational organization for training tuition.

A review of the IRS' financial systems data indicated that electronic payments have been used for similar vendors and expenses. This would indicate that the type of vendors identified might have the capability to accept electronic payments. Once the IRS establishes a vendor in its financial system as being waived from electronic payments, any subsequent payments to that vendor will also be automatically waived.

Though the IRS has made significant improvements in its use of electronic vendor payments, it could further maximize its efforts by considering the capability of vendors to receive electronic payments, and not simply establishing and maintaining automatic waivers based solely on expense type (e.g., administrative summonses and tax lien fees). This would be especially true for vendors who receive multiple check payments. The cost savings of more fully considering the capability of vendors to receive electronic payments and the affect on the IRS' percentage of electronic payments would be minimal, but it would further increase the IRS' compliance with the intent of the Debt Collection Improvement Act of 1996.

### **Recommendation**

1. The CFO should periodically review automatic waivers to identify vendors that are receiving recurring check payments. These vendors should be contacted in an attempt to obtain electronic payment information needed to pay the vendors electronically.

Management's Response: The BFC will conduct quarterly operational reviews to ensure that vendors who receive multiple payments are contacted to ascertain their capability of receiving electronic payments.

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### **Appendix I**

#### **Detailed Objective, Scope, and Methodology**

Our overall objective was to determine whether the Internal Revenue Service (IRS) has developed and implemented a process to maximize the use of electronic payments including the granting of waivers, as intended by the Debt Collection Improvement Act of 1996.<sup>1</sup> To accomplish our objective, we:

- I. Gained an understanding of the requirements of the Debt Collection Improvement Act of 1996 (Act).
- II. Determined whether the IRS had established a system with sufficient internal controls to ensure compliance with the Act.
- III. Determined whether established procedures had resulted in a process that ensured the maximum use of electronic payments.
  - A. Obtained a listing of all IRS-approved vendor payments for the period January 1 to July 31, 2002.
  - B. Reviewed the supporting documentation for vendors with waivers and evaluated if the waivers were in compliance with the intent of the Act.
  - C. Identified why vendors without waivers received checks.
  - D. Performed an analysis of all payments to identify patterns in which vendors received payments by check.
  - E. Identified reasons why some vendors were not receiving payments electronically and evaluated alternatives to overcome those obstacles.
- IV. Determined whether process monitoring was sufficient to ensure maximum use of electronic payments.
  - A. Discussed the IRS' process to calculate the percentage of electronic payments and efforts to increase electronic payments when percentages were lower than acceptable.
  - B. Identified guidance issued by the Chief Financial Officer's office concerning the requirements of electronic payments and any reviews that were completed to ensure compliance with the guidance.

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<sup>1</sup> Debt Collection Improvement Act of 1996, 31 U.S.C. § 3332.

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**Appendix II**

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

John R. Wright, Director

Thomas J. Brunetto, Audit Manager

S. Kent Johnson, Senior Auditor

Richard Loudon, Auditor

Carolyn Miller, Auditor

Peter Stoughton, Auditor

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**Appendix III**

**Report Distribution List**

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Audit Liaison: Chief Financial Officer N:CFO

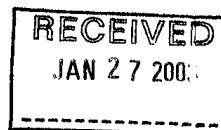
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Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



January 27, 2003

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR  
TAX ADMINISTRATION

FROM: W. Todd Grams *WTB*  
Chief Financial Officer

SUBJECT: Draft Audit Report – Significant Progress Has Been Made to  
Increase the Percentage of Electronic Vendor Payments  
(Audit # 200210027)

We have reviewed your draft audit report on our efforts to increase the percentage of electronic vendor payments and we are pleased to find that the report recognizes our progress in this area. Our response to the recommendation contained in the draft report is attached.

The Chief Financial Officer (CFO) staff has worked diligently to ensure IRS' compliance with final rules for implementing the Debt Collection Improvement Act of 1996. As your report cites, IRS has dramatically increased compliance from 64.3 percent in the first quarter of FY 2002 to 96.5 percent in the final quarter of FY 2002.

The Beckley Finance Center (BFC) reviews each payment to ensure IRS fulfills the spirit and the intent of the legislation. We conduct daily reviews to ensure all check payments are proper. In addition, we have taken a proactive approach in contacting vendors to explain the legislative requirements and to attempt to secure consent and the information required to issue electronic payments.

I will ensure IRS' continued leadership in the area of electronic government -- one of the five key elements in the President's Management Agenda.

If you have any questions, please contact me at 202.622.6400, or have a member of your staff contact Fred Keefer, Chief, Commercial Accounts Payable Branch, Beckley Finance Center, at 304.254.8020.

Attachment

## Significant Progress Has Been Made to Increase the Percentage of Electronic Vendor Payments

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### Response to Draft Audit Report Recommendation TIGTA Audit # 200110027

**IDENTITY OF RECOMMENDATION 1:** The CFO should periodically review its automatic waivers to identify vendors that are receiving recurring check payments. These vendors should be contacted in an attempt to obtain electronic payment information needed to pay the vendors electronically.

**ASSESSMENT OF CAUSE:** Payments on administrative summonses tend to be nominal in amount (less than \$100) and it is difficult for banks and financial institutions to properly account for the funds if insufficient information is included. Many problems are also encountered with respect to state and local government entities receiving payments for recordation and/or releases of Federal Tax Liens. Many of these entities are not equipped to receive electronic funds transfer (EFT) payments due to the composition of the local government and due to requirements to change banking accounts on an annual basis.

**CORRECTIVE ACTION:** The Beckley Finance Center (BFC) continually reviews the capabilities of vendors who qualify for waivers to accept electronic payments. The BFC will conduct quarterly operational reviews beginning with data from the second quarter (January – March) of FY 2003 to ensure that vendors who receive multiple payments are contacted to ascertain their capability of receiving electronic payments.

**PROPOSED IMPLEMENTATION DATE:** May 1, 2003

**RESPONSIBLE OFFICIAL:** Associate Chief Financial Officer for Internal Financial Management

**CORRECTIVE ACTION MONITORING PLAN:** The BFC will conduct quarterly reviews during FY 2003 to determine if IRS should further optimize its efforts with vendors who are most likely capable of accepting electronic payments. The CFO organization has established an FY 2003 business measurement goal to increase the EFT percentage of payments to vendors from 96.5 percent to 98 percent. Achieving the 98 percent goal will require contacting vendors receiving manual checks in order to expand the population of vendors receiving electronic payments. This data will be retrieved from the Automated Financial System (AFS) and will be tracked to determine if this business measure is achieved.